

INTERNATIONAL CITY MANAGERS' ASSOCIATION

1313 EAST 60TH STREET - CHICAGO 37, ILLINOIS

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PROCEDURE IN PURCHASING MUNICIPAL INSURANCE

How can a city best analyze its insurance problem and what steps can be taken to improve coverages and reduce costs?

Competition is returning in the insurance field. The stock fire insurance companies in the United States, according to the Wall Street Journal (12-28-49), had underwriting profits of \$117,000,000 in 1948, half again as big as in any previous year. Then in 1949 these profits were more than doubled. But during the years 1944 to 1947 insurance companies had underwriting losses and the insurance rates were increased. Now, however, with the high profits, the rates may be cut on order of state regulatory agencies. Significantly, a study of fire insurance rates has been launched in New York State.

A midwestern city of 10,000 population recently effected a considerable saving in purchasing automobile, public liability, and workmen's compensation insurance on a competitive basis. Low bids also have been received on fire insurance. The methods followed by this city are reviewed in this report for the guidance of other cities that want to reduce insurance costs.

Survey of Insurance Carried. An analysis of the kinds of insurance carried by the city showed that during the 1948-49 fiscal year a total of \$8,603 was paid out in premiums for automobile, boiler, fire and accident, surety bond, workmen's compensation, and public liability insurance, and that slightly over one-half of the total premiums were paid to one insurance agency with the remainder divided among four other agencies in the city.

The analysis further revealed that the city was carrying fire, theft, and all other types of insurance on a piece of fire apparatus which was in storage, that some of the larger policies for fire and boiler insurance were on an annual premium basis, that more money was being paid out in premiums for collision, fire, theft, and windstorm insurance on automobiles than for bodily injury and property damage, and that workmen's compensation coverage was being carried on some employees who were excluded by law from such coverage.

The city's chief administrator recommended to the council that a competent firm of insurance auditors be employed to analyze all insurance coverage in more detail and to make recommendations on how the city could improve coverages and reduce costs. This proposal was approved by the council and the Insurance Audit and Inspection Company (Hume Mansur Building, Indianapolis) was engaged to make the audit and provide a continuing supervisory service for one year. In addition, the local library and park boards secured the services of the same concern under separate contracts but at comparatively low fees made possible by the city paying more than the minimum charge.

The total fee, agreed upon in advance, covered the survey and report as well as consulting and follow-up service for one year. Within approximately two months the report of the auditing concern was received and steps were taken immediately

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to carry out some of its recommendations. The first step was to get bids and the chief administrator prepared "invitations to bid" which the audit company reviewed.

Liability Insurance. The bid form for liability insurance (see last two pages) was given top priority because of the city's propane gas operations. Previous attempts to secure adequate insurance on this operation had shown that most insurance companies either did not want this business or were willing to accept it only at very low limits. The "invitation to bid" was sent to 16 insurance companies. Twelve companies would not submit bids, and of the four bids received the bid of only one company met all conditions of the specifications. The other three bids either made certain exclusions that were not acceptable or designated limits lower than specified.

The bid which met all the specifications was also the lowest bid and was submitted by a stock company. The bid of this concern was only one-fourth of the price submitted by the other bidders. The reason for the low bid was that this company was not a member of the rating bureau to which the other stock companies subscribe and was therefore free to establish its own rates and set up its own rules. This particular company based its prices on rates that were 50 per cent below the manual rates. An additional 25 per cent was allowed by the company because a loading factor for hazardous operations (blasting, explosions, cave-ins, and so on) was not applied to gas and water utility operations. In addition to the extremely low rates the low bidder also agreed to provide much broader coverage than was originally anticipated.

Specifically the blanket public liability coverage included all types of liability, excluding only workmen's compensation and automobiles, and applied to all operations of the city, library, and park board. Under the liability policy previously carried employees engaged in the following operations were not covered: cemetery, park, golf course, streets and sidewalks, water softener, police, and fire. In addition, the new policy carries bodily injury coverage of \$25,000 and \$250,000 and property damage coverage for \$25,000 to \$250,000 with \$500 deductible per claim. Under the previous policy the limits of liability had been \$10,000 and \$20,000, and \$10,000 and \$25,000 respectively.

Workmen's Compensation Insurance. The audit concern suggested that the city ought to carry workmen's compensation insurance with the same company that carried the liability insurance in order to avoid possible conflict if the coverage were carried in two separate companies. Of the several companies submitting bids, the lowest price was from the same stock company that had the lowest rate on the liability insurance. The rate submitted was 29.2 per cent below the manual rates and considerably below the 13.5 per cent credit promulgated by the rating bureau.

Automobile Insurance. When the insurance company that carried the city's automobile insurance learned that city officials were going to ask for competitive bids, the company voluntarily reduced the annual premium on the comprehensive and collision insurance from slightly more than \$700 to less than \$400 a year. Subsequently an "invitation to bid" was sent out and three companies submitted bids. It was found that insurance with property damage limits of \$5,000 and with \$50 deductible per claim provided rates 40 per cent less than the \$5,000 property damage limit without a deductible amount. Bids on bodily injury and property damage insurance on city automobiles showed that rates on \$50,000 and \$100,000 for bodily injury were roughly 4 per cent higher than on \$25,000 and \$50,000. The city expects by next summer to carry all automobile insurance under two fleet policies, one for property damage and bodily injury, and the other for comprehensive and collision.

Fire Insurance. The audit company recommended that the city carry its own insurance on small values where the risks are widely scattered, that the ideal coverage would be a blanket form policy written without co-insurance or other restrictions as to the ratio of insurance to value, that building and contents would be covered in one item, and that the policy run for three years (instead of annually) to effect a saving of 16-2/3 per cent in premiums. The audit concern also suggested that the city should get bids from one of the Associated Factory Mutuals (list of companies available from Factory Mutual Engineering Division, 84 High Street, Boston 10) and from the Factory Insurance Association (555 Asylum Street, Hartford 2, Connecticut).

The city next requested the Associated Factory Mutuals (AFM) to survey municipal properties and submit a proposal. The city also informally contacted its local agent handling fire insurance for the city and informed him of the above recommendations made by the audit concern. This local agent, however, believed that the city should deal only with local agents, regardless of how much more it cost the city. The local agent made no attempt to contact the Factory Insurance Association because he believed that no improvements could be made in the coverage. (The FIA will come into a city only on request of a local agent.)

The AFM proposal received by the city was a detailed statement of eight pages. AFM proposed to insure in the Factory Mutual companies all real and personal property of the city listed in three groups. The first group provided coverage of \$390,000 and included the city hall, pumping station, two elevated water tanks, two reservoirs, and a pumphouse building. The second group (\$155,000) included two garages, storage building, propane gas mixing and control building, four propane tanks, unloading equipment, governor house, gas holders, and an old gas plant. The third group (\$165,000) included four sewage treatment plants and a lift station. The coverage would include all loss or damage caused by the hazards of fire, sprinkler leakage, wind damage or hail, lightning, explosions of every kind, aircraft and vehicles, smoke damage, riot and civil commotion, and vandalism and malicious damage. The amount of insurance to be carried on the three groups of properties totalled \$710,000.

The Factory Mutuals offered to write the policy on the usual sound value basis (replacement cost less physical depreciation) or on the basis of replacement cost. The proposal defined in detail the supplemental coverages that would be provided, including malicious damage done by disgruntled employees, strikers, enemy agents, or any other person or persons of malicious intent--a new feature which was effective January 1, 1950.

The Factory Mutuals require a premium deposit which is the same whether the policy is written for a one or three-year term. The AFM proposal therefore provided for a premium deposit of \$5,325, or approximately 75 cents per \$100 of insurance. The estimated cost on a three-year basis for the total coverage of \$710,000 was set at \$1,652, based on present "absorption" rates. At the end of the policy term the portion of the premium deposit which is unabsorbed is returned or credited to the policyholder. The deposit plan is explained in a pamphlet entitled "Factory Mutual Premium Deposit Accounting," issued by the Cotton and Woollen Manufacturers' Mutual Insurance Company of New England, 60 Batterymarch Street, Boston.

The three-year premium of \$1,652 is considerably less than the net premium of \$1,447 the city paid this year for a one-year premium on less extensive coverage. The new three-year premium, however, was based on compliance with a recommendation that automatic sprinkler protection be provided for the underside of the combustible

roofs of both pumping stations. This would cost the city approximately \$1,000. Limitations on value could be placed on other buildings needing protection, but where value of the buildings does not justify sprinkler installation there would be no increase in cost of insurance.

City officials questioned the legality of the city making a deposit in a mutual insurance company. It was pointed out, however, that in 1941 the Missouri Attorney General's office at the request of the officials of Clinton County, Missouri, ruled that cities, counties, and school districts could insure in mutual companies where liability is fixed. The Attorney General also ruled that where the assessments are limited to some such sum as five times the original premium the municipality does not pledge its credit. (The federal housing agency carries insurance in Factory Mutuals at 145 locations throughout the country and a number of municipal housing authorities, school boards, and cities carry insurance with the AFM.)

The AFM proposal stated further that their Engineering Division maintains fully staffed district offices throughout the country, and services furnished at no additional cost include periodic inspections of insured property and a complete appraisal of buildings, machinery, and equipment. This was important because the appraisal made by the Factory Mutuals saved the city several hundred dollars.

When local fire insurance agents heard that the city council was considering the AFM proposal, they raised strenuous objections. The council therefore sent the following "bid invitation" to the local agents:

"City of _____

INVITATION TO BID ON FIRE INSURANCE

"Bids will be received up to 7:30 P.M., February 6, 1950, on fire and extended coverage insurance, including vandalism and malicious mischief, on all real and personal property belonging to the city.

"Present policies may be reviewed at the City Hall by contacting the City Clerk.

"The City has been advised that its properties should be considered for superior insurance treatment, consisting of a single item blanket from covering all real and personal property belonging to the City, and written without co-insurance or other restrictive requirement as to the ratio of insurance to value. As a next best step, a General Form policy has been recommended, which would combine as many as possible of items and properties that are now separated.

"Bidders should take into consideration possible advantages from installing sprinkler protection or fireproofing in various City properties. Bids should be complete in every detail, including costs of recommended improvements and subsequent savings in premium, and should show one, three, and five-year costs for each property.

"Any inquiries or correspondence should be referred to the City Clerk, City Hall, _____." January 26, 1950."

In response to this invitation the city received bids from two local agents but neither of these bids compared favorably with the AFM bid either in cost or coverage. But the local agents continued to object to the city awarding the

insurance to the AFM, pointing out that they (the local agents) are governed by the state insurance laws which do not apply to the Factory Mutuals. (The city council at the time this MIS report was issued had not acted on awarding the fire insurance.)

Conclusion. The experience of this small midwestern city shows that some insurance companies, recognizing the low loss experience on municipal property, will submit competitive bids and that insurance can be bought the same as any other commodity. A city is not justified in awarding insurance business on grounds other than the best coverage at the best price. The city should apply to insurance buying the same procedures that are applied to buying other commodities. When requesting bids from stock companies the city should set up a minimum standard for an acceptable company. Generally an A:BBB rating is the lowest acceptable minimum used by cities and some cities require an A:AA rating in Best's Insurance Guide.

A city generally can purchase nonassessable mutual insurance if the city council expressly so provides. According to the state insurance department of Wisconsin there is no instance in the United States where a policyholder of a mutual nonassessable policy has ever been required to pay an assessment. Assessments against policyholders are ordered from time to time but only in respect to insolvent mutual companies which do not have the right to issue nonassessable policies.

Cities can and do carry insurance with mutual companies that limit the amount of the assessment, as in the case of the Factory Mutuals. A policyholder in a mutual company is not a stockholder in the company. Where the assessment is limited there is no pledging of credit by the city, but if the city attorney should rule differently on this point the city can protect itself against a possible assessment. The Factory Mutuals, for example, require a deposit against which premiums are charged and the unused portion of which is returnable on cancellation of the policy. This deposit represents one-fifth of the total amount the city might be assessed by the company. One city, for example, which put up a deposit of \$5,000 with a mutual company paid \$25 a year for a special policy against a possible assessment of \$25,000.

The Factory Mutuals include nine companies, the oldest of which was organized in 1835 and the most recent in 1887. The system insures and furnishes fire protection engineering service to over 21,000 plants throughout the United States and Canada with total insurance in force of over \$31,400,000,000 on high grade industrial properties. The Factory Mutual companies operate their own rating schedules and maintain their own engineering and inspection department so that the policyholder of these companies does not come within the jurisdiction of any other rating or inspection body.

The Factory Mutual companies select for insurance only plants or buildings of good construction in which hazardous processes are properly arranged and safeguarded, and only buildings with automatic sprinkler protection wherever there is combustible material in the construction or occupancy. Factory Mutual policies carry an assessment liability equal to five times the premium deposit but no assessment of any kind has been made during the 115 years the companies have operated. (Assessment liability can be re-insured through Lloyds at nominal cost.)

The experience of the small city with which this report has been concerned shows that cities might consider the advisability of securing the services of insurance analysts who render a consulting service wholly independent of the sale of insurance. Such firms often are employed by large business concerns to review insurance portfolios to make sure that risks under changing conditions are adequately

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covered and that insurance premiums are not being wasted. The "big three" of the insurance analysts' profession, according to the Wall Street Journal, are: in the East, John Blades, 744 Broad Street, Newark, New Jersey; in the Midwest, the Insurance Audit and Inspection Company, Hume Mansur Building, Indianapolis; and in the far West, Mund, McLaurin and Company, 114 Sansome Street, San Francisco.

Briefly, a city buying insurance should know exactly what it wishes to insure and prepare a proposal to send out for bids. Bids from companies that do not meet specifications should be thrown out. An expert appraisal and survey should be made to ascertain what improvements or changes can be made to secure lower rates and the most comprehensive coverage, and finally, the city might consider eliminating some coverages, such as fire insurance on widely scattered risks that are not especially hazardous and could safely qualify as calculated risks.

Finally, large cities may well consider carrying their own risks, and many cities will find it economical to buy deductible policies. An analysis of losses over a period of years on various types of coverages in relation to premiums paid for insurance may show such a low loss that the city would not be justified in carrying insurance. A survey of fire insurance on city-owned property over a 10-year period in 10 states, made by the American Municipal Association, showed a loss ratio of 14 per cent.

Generally, there is little advantage for the larger cities to carry fire, theft, and liability insurance on motor equipment. If a city desires to cover itself partially against possible fire losses on public buildings, it should determine the largest single loss the city can readily meet and then take out insurance on losses that might occur in excess of this minimum.

Note: Officials of cities that subscribe to MIS may obtain on request loan copies of specifications for public liability insurance on motor equipment and for burglary and robbery. For additional information on buying insurance see MIS Report No. 33, entitled "How to Reduce Municipal Insurance Costs," issued in February, 1947.

(Specifications used by a small midwestern city in obtaining bids on coverages specified.)

CITY OF _____

INVITATION TO BID

on

WORKMEN'S COMPENSATION AND PUBLIC LIABILITY INSURANCE

- I. Standard Workmen's Compensation and Employer's Liability Insurance (including occupational disease), for operations listed under A and C of attached summary.

Three year experience as follows: (per Travelers Insurance Co.)

Year	Medical Payments Made	Compensation Paid	Premium Paid		Equity Credit
1946-47	\$110.00	\$55.00	\$1,157.06	Earned	25%
47-48	316.44	200.00	1,844.08	"	25%
48-49	89.50	---	1,276.54	Advance	13.5%

(During the above three years, an additional amount was paid on a claim filed prior to June 30, 1946 by a police officer: \$3,000 disability, \$617.60 medical, \$3.60 expense)

- NOTES: (1) Voluntary compensation endorsement limits to be \$10/25,000.
(2) Please show as separate item additional premium necessary to obtain full medical care coverage.

- II. Comprehensive Public Liability Policy, per attached Summary of Operations, limits as follows:

Bodily Injury Limits - Operations	25/100,000
" " " - Products	25/250,000
Property Damage Limits - Operations & Products -	
\$1,000 deductible	100/100,000
Alternate: \$1,000 "	250/250,000

- NOTES: (1) Hazards from blasting or explosions, collapse of or structural injury to buildings due to excavations, etc., are not to be excluded.
Show additional premium as separate item under each operation.
(2) Policy to include Immunity from Tort Liability waiver.
(3) Policy to cover "occurrences" instead of "accidents."
(4) City to have option of excluding police and fire operations and automobile liability from policy.
(5) Contractual liability to be on blanket basis.

Alternate:

- III. Operations and Products Liability Insurance, as follows:

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- A. Gas Works - Operations (Propane Air Gas)
- | | |
|---|-------------|
| Bodily Injury Limits - Operations Liability | 25/100,000 |
| " " " - Products | 25/250,000 |
| Property Damage - Operations & Products- | |
| \$1,000 deductible | 100/100,000 |
| Alternate: \$1,000 " | 250/250,000 |
- B. Other Operations - as listed under A (except A-7), C,D-1,2,3,4,5,
in attached summary of operations.
- | | |
|--|-----------|
| Bodily Injury Limits - Operations only | 10/25,000 |
| Property Damage " - " only | 5/10,000 |

NOTES: (1), (2), and (3) Same as under II above
(4) City to have option of excluding any operations it
deems advisable.

GENERAL: Bids are to be returned by Friday, September 23.

Bids are requested on both II and III and on all alternates.

Where park and library operations are included, the _____ Park Commission
and Board of Library Trustees are to be included as additional assureds.

Address all inquiries and correspondence to _____, City Hall.

Additional copies of these specifications are available if desired. Please
indicate if premium payments and audits can be placed on quarterly basis.

September 10, 1949.